Supreme Court of the United States

OCTOBER TERM, 1941

No._____

CHARLES B. RAYNER, *Petitioner*

vs.

UNITED NORTH & SOUTH DEVELOPMENT COMPANY

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

Opinions of the Courts Below

The opinion of the Circuit Court of Appeals is reported as *United North & South Development Co. vs. Rayner*, 124 F. (2d) 512. The oral opinion of the district court, delivered from the bench at the conclusion of the trial, is in the Record at pages 198-204. It has not been officially reported.

II.

Jurisdiction

1. The judgment of the Circuit Court of Appeals for the Fifth Circuit to be reviewed was entered December 29, 1941. (R. ~~224-228.~~) The petition for rehearing, filed January 17, 1942, (R. ~~230-235~~), was entertained by the court and was denied on February 2, 1942 (R. ~~236~~).

2. In the petition for the writ of certiorari it is pointed out that the Circuit Court of Appeals has decided important questions of local law in a way in conflict with applicable local decisions; and has rendered a decision in conflict with the decisions of other Circuit Courts of Appeals on the same matter; and has generally failed to follow the weight of reasoned authority.

3. The jurisdiction of this Court is believed to be sustained under U. S. C. A., Title 28, Section 347(a); Judicial Code, Sec. 240, as amended by the Act of February 13, 1925.

4. The following cases are believed to sustain the jurisdiction of this Court:

West vs. American Telephone and Telegraph Co., 311 U. S. 223;

Wichita Royalty Co. vs. City National Bank of Wichita Falls, 306 U. S. 103;

Erie Railroad Co. vs. Tompkins, 304 U. S. 64;

Mobley vs. New York Life Insurance Co., 295 U. S. 632, 633-634.

III.

Statement of the Case

In addition to the summary statement of the matter involved contained in the petition, petitioner calls the court's attention to the following:

After respondent corporation was organized in 1926 or 1927, its operations were directed by a "Management Committee," composed of petitioner and four other men, under an agreement with Edgar B. Davis that they were partners with Davis in the enterprise, and that they would receive a fair share of any profits that might be made by Davis through the company's operations. (R. 67, 71-72.) Through the efforts of the Management Committee a valuable oil field known as Darst Creek was acquired and developed for respondent and was later sold to Louisiana Oil & Refining Company for $2,250,000.00, payable out of oil. (R. 72.) After the above sale Davis gave petitioner as his share of the profits Davis' promissory note in the sum of $200,000.00. (R.78.) This note was later exchanged for a contract under which Davis was obligated to pay petitioner $200,000.00 within two years. (R. 78-79.) The contract was extended for some four months. (R. 74.)

In September, 1931, the proration laws of Texas prevented the Louisiana Company from producing 4000 barrels of oil daily as it had contracted to do, and the Louisiana Company turned the Darst Creek Field back to respondent. (R. 73.) The field has produced some 4,000,000 barrels of oil. (R. 73.) It is still producing, and under proration its 29 wells

are producing about 13,000 barrels of oil monthly. (R. 159.)

Petitioner in 1934 released Davis from the contract in exchange for five promissory notes of Davis, aggregating $234,176.13. (R. 74-75; release R. 38-39.) The first four of the five notes were later renewed and extended by Davis by endorsement thereon. (R. 20, 23, 26, 31.) The stock involved in the instant case was pledged to secure those notes and was properly endorsed for transfer. (R. 19-35.)

During the period from March 1, 1935, to April 4, 1938, Davis repeatedly wrote petitioner letters in which Davis acknowledged his "indebtedness" to petitioner and the sacredness of his "obligation" to petitioner. (R. 179-183.) Davis has never filed any suit to cancel the notes given petitioner. (R. 195-196.) He was a party to the garnishment suit filed by the State of Massachusetts against respondent to impound Davis' stock in respondent; and, although petitioner intervened in that proceeding and asserted the superiority of his right to Davis' stock pledged to him over the right of the State of Massachusetts to that stock (R. 171-175), Davis did not, by way of answer or otherwise, deny his indebtedness to petitioner.

Davis had a month's notice that petitioner was going to sell the pledged stock (R. 42-43); and after the sale was made (R. 48-49) another two months elasped before petitioner brought the instant suit against respondent. (R. 5.) Petitioner's suit was on file for six months before it was ever tried. (R. 5, 216.) During the entire period of time Davis never brought any suit attacking the validity of his

notes and pledge of stock securing the same. (R. 195-196.)

In Davis' letter to respondent and others in which he protested the sale of the stock by respondent, no claim was made that the notes and pledge of stock were not based upon an adequate consideration. (R. 50-51.)

In 1934 K. C. Baker filed suit against Davis and garnished Davis' stock in respondent corporation. Respondent filed an answer in the garnishment proceeding, and in its answer set out that Davis had pledged 11,709 shares of his stock in respondent to petitioner to secure his "indebtedness" to petitioner. The answer was sworn to as "true and correct" by the Treasurer of respondent corporation. (R. 166-169.) In the garnishment proceeding filed by the Commonwealth of Massachusetts against respondent to impound Davis' stock in respondent, respondent pleaded that Davis had pledged 11,709 shares of his stock in respondent to petitioner. The answer was sworn to as "true and correct" by the Assistant Treasurer of respondent corporation. (R. 104-106, 115.)

Miller Ainsworth, Vice President of respondent corporation, knew of Davis' debt to petitioner and in 1938, 1939, and 1940 had a number of conversations with petitioner in an attempt to work out the payment and settlement of Davis' obligation to petitioner. In these conversations Ainsworth did not contend that Davis was not indebted to petitioner; he merely attempted to work out some settlement of an admitted obligation. (R. 193-194.)

When respondent refused to transfer petitioner's stock, its letter of refusal was written by Ainsworth

and in the letter no contention was made that the notes and stock given to petitioner by Davis were not supported by adequate consideration. (R. 59-60.)

We have set out at pages 2-4, *supra*, the trial court's findings to the effect that respondent was dominated by Davis and that respondent refused to transfer the stock, not because of any bona fide belief in Davis' contentions, but to hinder petitioner in his attempt to collect the debt due him from Davis. In addition to the findings referred to, we call the Court's attention to the fact that Davis, on behalf of respondent, handled most, if not all, of its negotiations with petitioner concerning the transfer of his stock. When petitioner first presented the stock for transfer, Davis, acting on behalf of respondent, refused to make the transfer. (R. 52.) After this first refusal and after petitioner had again demanded transfer of his shares, it was Davis who wrote petitioner on behalf of respondent that he had just had the opportunity "to consult our San Antonio attorneys" and that a final answer would be given petitioner within a few days. (R. 55-56.) The "San Antonio attorneys" referred to by Davis were Davis' personal counsel. (R. 142-143.) The final letter of refusal was written by Ainsworth, who testified that Davis was the man who put him "on notice" that he, Ainsworth, should write petitioner refusing to transfer the stock. (R. 93.)

The garnishment proceeding referred to by the Circuit Court of Appeals was instituted to impound Davis' stock in respondent. On February 10, 1940, judgment was entered quashing the writ of gar-

nishment issued the State of Massachusetts in that proceeding and discharging the garnishee. (R. 120-123.) An appeal was taken from that part of the judgment quashing the writ of garnishment (R. 127), but no supersedeas bond was filed in connection with the appeal. (R. 130.)

Petitioner's demand on respondent that it transfer petitioner's stock was first made on October 21, 1940, some eight months after the quashing of the writ of garnishment (R. 53-54), and was thereafter again made on November 1, 1940. (R. 57-58.)

IV.

Specifications of Error

1. The Circuit Court of Appeals erred in ignoring the trial court's findings:

(a) That respondent knew the reasons given by it for its refusal to transfer petitioner's stock were not valid;

(b) That respondent knew of Davis' debt to petitioner, of the pledge of stock to secure the same, and knew that Davis' "grounds of protest were frivolous";

(c) That, in refusing to make the transfer, respondent did not act in good faith, but to comply with the demands of Davis (who owned 84% of its stock and who "dominated and controlled" the corporation) in order "to hinder Rayner (petitioner) in the collection of his debt."

2. The Circuit Court of Appeals erred in holding, contrary to the law of Texas, that petitioner's

demand for a transfer of his stock, plus Davis' claims and the pendency of the appeal in the Massachusetts garnishment proceeding, presented "technical legal issues" which the officers of respondent could not be expected to decide; and that their acting upon the advice of counsel relieved respondent from liability for conversion for refusing to transfer petitioner's stock.

3. The Circuit Court of Appeals erred in *failing* to hold that, if respondent had any doubt as to its duty to transfer petitioner's stock, it should have either filed an interpleader suit to get the matter determined or should have gotten Davis to file some character of suit to get the matter determined, and that, in the absence of either proceeding, respondent rested under the duty of making the transfer.

4. The Circuit Court of Appeals erred in holding, contrary to the law of Texas, that petitioner "should be relegated to either a mandamus, an injunction, a suit for specific performance, or other proceeding in which the title to the stock can be determined."

5. The Circuit Court of Appeals erred in holding that the fact that petitioner bid in the stock for $1.00 per share (after Davis chilled the bidding), with the consequence that Davis may receive a credit of only $11,709.00 on his notes, "created a legal situation which the officers of defendant (respondent) were not qualified to decide," and that as a consequence respondent was relieved from liability in conversion for its refusal to transfer petitioner's stock because:

(a) Under the law of Texas petitioner was called upon to decide the legal question presented and to decide it correctly;

(b) Under the law of Texas, as petitioner has repeatedly admitted, Davis is entitled to receive as a credit on his notes the value of the stock bought in by petitioner, the pledgee, irrespective of the purchase price;

(c) Under the law of Texas petitioner, as the pledgee of the stock properly endorsed, had the right to have the stock transferred with or without a sale —and consequently what happened at the sale was no concern of respondent.

6. The Circuit Court of Appeals erred in holding, contrary to the weight of reasoned authority, that respondent could urge as a defense to petitioner's suit for conversion Davis' claim that petitioner's notes were without consideration and that the pledged stock, when sold, was sold for an inadequate price, because these two grounds were not mentioned in respondent's letter to petitioner in which respondent refused to transfer his stock.

V.

Summary of the Argument

1. The Circuit Court of Appeals held that respondent could not be held liable for its refusal to transfer petitioner's shares because Davis' claims and the pendency of the appeal in the Massachusetts garnishment proceeding raised "technical legal issues" which the officers of respondent were not

called upon to decide. This holding is erroneous because:

(a) Respondent did not act in good faith belief in these defenses, but knew they were fictitious, and acted to hinder petitioner in his attempt to collect a debt owed him by Davis, who dominated and controlled respondent. Under Texas decisions and under general principles the Circuit Court of Appeals should have looked at the matter realistically and ignored the corporate fiction, as did the trial court. Instead, the Circuit Court of Appeals disregarded the relationship between Davis and his corporation.

(b) Under the Texas decisions and under general principles a corporation called upon to transfer stock has to decide "technical legal issues," and, if the corporation refuses because of an erroneous decision with respect to such issues, it is nevertheless liable for conversion.

(c) The weight of reasoned authority is that a corporation, when confronted with a request for the transfer of stock and with conflicting claims to the stock that present "technical legal issues," must either file an interpleader suit to get those issues decided, or get the adverse claimant to file a suit to get the issues decided, or transfer the stock to the first claimant. The Circuit Court of Appeals held, on the contrary, that because "technical legal issues" arose, as the result of the adverse claims of Davis, respondent was discharged of any liability in the premises.

(d) The weight of reasoned authority is that a corporation refusing to transfer stock must inform

the party seeking the transfer as to its reasons for the refusal, and that any ground not put forward at that time is waived. Respondent did not give as reasons for not transferring petitioner's stock the fact that Davis was contending (a) that his notes and pledge of stock were not supported by an adequate consideration, and (b) that the stock sold for an inadequate price. Consequently, the Circuit Court of Appeals erred in holding that Davis' claims in these respects raised "technical legal issues" which the officers of respondent were not called upon to decide and which relieved respondent of liability for its refusal to transfer.

2. The Circuit Court of Appeals held that, as petitioner bought in the stock for $1.00 per share (Davis having chilled the bidding), Davis may receive a credit of only $11,709.00 on his notes, whereas, the trial court found that the 11,709 shares of stock were worth $8.05 per share, and that this "created a legal situation which the officers of defendant (respondent) were not qualified to decide," and that as a consequence respondent was relieved of liability for its refusal to transfer. This holding is erroneous for the following reasons:

(a) Under the law of Texas respondent was called upon to decide the legal questions presented and to decide them correctly.

(b) Under the law of Texas, as petitioner has repeatedly admitted, Davis is entitled to receive as a credit on his notes the value of the stock bought in by petitioner, the pledgee, irrespective of the purchase price.

(c) Under the law of Texas petitioner, as the pledgee of the stock properly endorsed, had the right to have the stock transferred with or without a sale —and consequently what happened at the sale was no concern of respondent.

(d) Davis, having chilled the bidding, could not complain of the sale price and consequently respondent could not thereby be relieved of liability in conversion for its refusal to transfer the stock.

VI.

Argument

1. (a) The trial court took a realistic view of the case and reached the conclusion that respondent was not a free agent when it refused to transfer petitioner's stock. The trial court found, and the record clearly reflects, that respondent, because of Davis' control of it, played the part of a useful buffer between Davis and petitioner. The Circuit Court of Appeals carried legal formalism beyond all reason by ignoring the relationship between Davis and his corporation and by holding that Davis' claims, without more, relieved respondent of liability for its refusal to transfer petitioner's stock.

The Circuit Court of Appeals held that Davis' unsupported claims were enough; that it was immaterial that they furnished the respondent with an *excuse* rather than a *reason* for its refusal to transfer; that it was immaterial that it acted to protect Davis; and that it was immaterial that it knew Davis' contentions were frivolous. The Circuit

Court of Appeals reasoned that a corporation is a corporation, and a stockholder, a stockholder, and that it was unnecessary to examine into the relationship between them. This was clearly wrong under the Texas decisions, which the Circuit Court of Appeals should have followed, holding that the corporate fiction should be ignored where necessary to prevent fraud. *First National Bank in Canyon v. Gamble*, 134 Tex. 112, 119-120; *Pacific American Gasoline Co. of Texas v. Miller*, 76 S. W. (2d) 833, 851 (Tex. Civ. App.). The trial court looked beneath the corporate shell and found Davis; the Circuit Court of Appeals did not look. The trial court recognized the voice of Jacob; the Circuit Court of Appeals saw only the hand of Esau.

(b) Assuming for the moment, contrary to the trial court's unimpeached findings and the record, that Davis and respondent dealt at arms length, the Circuit Court of Appeals, nevertheless, erred in holding that because "technical legal issues" were raised by petitioner's demand for transfer, Davis' claims and the garnishment proceeding, respondent's officers were discharged of all duty in the premises, and that petitioner was relegated to a mandamus proceeding to compel a transfer. This holding was clearly wrong under Texas law. In Texas the refusal of a corporation to transfer stock properly endorsed for transfer is a conversion of it, and the party requesting the transfer has the option of compelling a transfer by means of a mandamus proceeding or of recovering actual damages caused by the conversion. *The Rio Grande Cattle Co. v. Burns, Walker & Co.*, 82 Tex. 50, 57; *Bower v. Yel-*

low Cab Co., 13 S. W. (2d) 708 (Tex. Civ. App.); *Gresham v. Island City Savings Bank*, 21 S. W. 556, (Tex. Civ. App.)

Under Texas decisions a converter of property is liable in actual damages for the conversion, irrespective of his good faith in the premises. *Pecos & N. T. Ry. Co. v. Porter*, 183 S. W. 98, 102 (Tex. Civ. App.). Consequently, the fact that respondent relied upon the advice of counsel, ostensibly consulted because of the technical legal issues that had arisen, was immaterial. The only question presented was whether petitioner owned his stock and had the right to have it transferred. The trial court found that he did own the stock and did have the right. As a consequence, respondent was guilty of a conversion in refusing to transfer it; the state of the corporate mind was immaterial.

It is clear from the Texas decisions as well as from the federal decisions that the above principles apply when a corporation is confronted with a request for the transfer of certain stock, and that it may be faced with "technical legal issues" and may be forced to determine those issues correctly in order to escape liability. Public policy will not, under these circumstances as well as under most others, permit ignorance of the law or unsound advice of counsel to be a defense.

In *Rio Grande Cattle Co. v. Burns, Walker & Co.*, 82 Tex. 50, the company was held liable in damages for refusing to transfer stock although its refusal was based upon the belief that a certain written agreement entered into by the original incorporators turned the corporation into a partnership. The court admitted in its opinion that the "agreement under

consideration in many of its features assimilates nearer to a partnership in defining the rights and liabilities of its members than to a corporation." (82 Tex. 55.) The court held, nevertheless, that the agreement did not turn the partnership into a corporation and that the corporation was guilty of conversion. The court evidently considered it immaterial that the demand for the transfer raised a technical legal issue.

In *London, Paris & American Bank v. Aronstein*, 117 Fed. 601 (9th Circuit), cert. den. 187 U. S. 641, the court held a corporation liable in damages for refusing to transfer stock upon demand of an executor. The corporation acted under the belief that the law of England, which required that the decedent's estate be administered upon at the domicile of the corporation in England before a transfer could be made, was controlling. The court held, in four pages of legal reasoning, that certain provisions in the California Constitution overrode the law of England which would have required administration of the decedent's estate in England.

Under the above decisions how can it be said that respondent was justified in refusing to transfer petitioner's stock because petitioner's demand for the transfer, under the circumstances that existed, raised "technical legal issues"? How can it be said, for example, that the pendency of the Massachusetts garnishment proceeding raised a "technical legal issue" which the officers of respondent were not called upon to decide, and that, as a consequence, respondent could refuse to make the transfer? If comparisons are to be made, it took no more legal acumen to correctly decide the "technical legal issues" presented in

the *Rio Grande Cattle Company* case and the *Aronstein* case than it would have taken to correctly decide the legal question presented to respondent by the pending appeal in the garnishment proceeding and petitioner's demand for a transfer of his stock. In fact it took less, because the Texas law clearly is that the entry of a judgment quashing a writ of garnishment and discharging the garnishee places all parties in the position they occupied before the writ was issued, and an appeal from the judgment will not restore the status quo or in any way prevent the parties from acting as though the writ had never issued, unless a supersedeas bond is filed.

The Circuit Court of Appeals' holding comes to this: First, that a corporation can refuse to transfer stock merely because some third party questions the right of the party requesting the transfer; and, second, that a corporation can refuse to transfer stock and be relieved of any liability in conversion if it has the foresight to consult counsel and obtain an opinion supporting its action.

The first proposition is answered by Judge Sanborn in *O'Neil v. Wolcott Mining Co.*, 174 Fed. 527, 534 (8th Circuit), where he holds that, if the mere questioning by a third party of the claimant's right to a transfer could justify a refusal by the corporation, "it would come to this, that anybody giving notice would stop a transfer."

As to the second proposition, if acting on the advice of counsel is a defense to a suit for conversion based upon a corporation's refusal to transfer stock, there would rarely be a case in which liability could be established.

(c) If respondent was doubtful as to what should be done when petitioner called upon it to transfer his stock, it had ample means of protecting itself. It could and should have filed an interpleader proceeding to get the legal questions, if any, determined. If it did not want to file such a proceeding, and if it placed any faith in Davis' claims (the trial court found that it did not), it should have gotten Davis to file some character of suit to test the legal questions, if any, involved. It did not have the right to rely on the bare claims of Davis and the advice of counsel and refuse to transfer the stock unless it was willing to assume liability for its refusal. The leading cases are *O'Neil v. Wolcott Mining Co.*, 174 Fed. 527, 533-534 (8th Circuit); *State ex rel. v. McIver*, 2 S. C. (2 Rich.) 25, 44; and *Spangenberg v. Nesbitt*, 22 Cal. App. 274, 278-279. The holdings of those cases are summed up in 18 C.J.S., Corporations, sec. 435, p. 1051 (cited by the Circuit Court of Appeals) as follows:

" . . . where notice is given of an adverse claim which might be lost or injuriously affected by the transfer, the registration should be delayed until the rights therein can be determined by an investigation, or, if necessary, by a legal proceeding. In such a case, the corporation officers are not required or permitted to assume the functions of a court, and by their decision to forever conclude the rights of the contending claimants, and if resort is not had to the courts within a reasonable time, it becomes their duty to register the stock in the name of the first claimant."

(d) Respondent waived any defense based upon Davis' claim that his notes and pledge of stock were

not supported by an adequate consideration and that the stock sold for an inadequate price at the sale because it did not present those grounds as a reason for its refusal to transfer the stock in its letter to petitioner refusing to make the transfer. In *Tobias v. Wolverine Mining Co.*, 52 Idaho, 576, 585, the court stated:

"All of the reasons for the refusal (the refusal to transfer) must be given to the applicant for transfer, as any reasons not given will be considered waived. A defense not asserted at the time of the refusal to transfer cannot be raised at the trial of an action for such refusal."

To the same effect as the above are *In re Klaus*, 67 Wis. 401, 402-403; *Spangenberg v. Nesbitt*, 22 Cal. App. 274, 280; Christy, *The Transfer of Stock*, page 466.

2. The Circuit Court of Appeals lays stress upon the fact that petitioner bid in the stock at the foreclosure sale for $1.00 per share. It seems to be the idea of the Circuit Court of Appeals that Davis may in some way be prejudiced by the fact that the stock, which the trial court in the instant case found was worth $8.05 per share, sold for $1.00 per share at the foreclosure sale. According to the Circuit Court of Appeals this fact situation "created a legal situation" which the officers of respondent were not called upon to decide. There are a number of answers to this contention.

(a) As pointed out at pages 27-30, *infra*, if the factual situation under discussion "created a legal situation," the duty rested on respondent and its officers to cope with it.

(b) Davis cannot in any way be prejudiced by the price for which the stock sold at the foreclosure sale because the law in Texas is that, where the *pledgee* of stock buys the stock in at the sale, the debtor must be credited with the full value of the stock, irrespective of the selling price. This is the holding in *King v. D. Sullivan & Co.*, 92 S. W. 51, 52-53 (Tex. Civ. App.). Throughout this proceeding petitioner had admitted this to be the law of Texas.

(c) Under the law of Texas petitioner, as the pledgee of stock properly endorsed, had the right to have the stock transferred with or without a sale. *Seeligson & Co. v. Brown*, 61 Tex. 114, 117; *Cavitt v. Gulledge*, 255 S. W. 784, 787 (Tex. Civ. App.); *Davis v. Hardwick*, 94 S. W. 359, 361 (Tex. Civ. App.). Consequently, respondent could not have been concerned, or should not have been concerned, when the demand for transfer was made, with what, if anything, had happened at the foreclosure sale.

(d) The stock pledged to petitioner sold for $1.00 because of Davis' action in chilling the bidding by giving written notice to all prospective bidders that any purchaser of the stock would be buying a lawsuit. (R. 50-51.) It seems self-evident that the Circuit Court of Appeals erred in giving consideration to the selling price of the stock to protect Davis when Davis was responsible for the low price for which the stock sold. It seems too clear for argument that Davis could not complain of the price at which the stock sold, and it is difficult to see why the respondent should be permitted to assert a right that Davis could not assert.

VII.

Conclusion

It is respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, and that to such end a writ of certiorari should be granted; and that this Court should review the decision of the Circuit Court of Appeals for the Fifth Circuit and should finally reverse it and affirm the judgment of the trial court.

Respectfully submitted,

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